STRICTLY CONFIDENTIAL VERSION

Application for an Exemption pursuant to Section 11 Electricity Industry Act 2010

Date:	3 May 2024
Applicant:	WEL Networks Limited 114 Maui Street Te Rapa Hamilton
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Application:	Pursuant to section 11(2) of the Electricity Industry Act 2010 (**Act**), application is hereby made to the Electricity Authority (**Authority**) for an exemption from compliance with clause 6A.3 under Part 6A of the Electricity Industry Participation Code 2010 (**Code**).

CONTENTS

1. EXECUTIVE SUMMARY

1.1 WEL Networks Limited ("**WEL**") is currently in the process of developing two solar farms ("**Solar Assets**") and a network battery (the "**BESS**") (as further detailed under paragraph 3.3 below and defined together as the "**New Generation Assets**") which it plans to incorporate into its business. Once connected to WEL's network, it is understood that, from 1 June 2024, the total capacity of these New Generation Assets,[1] together with WEL's limited existing generation capacity connected to its network (as described in footnote 10 below), will exceed the 50MW threshold that triggers the corporate separation and arm's-length compliance requirements under clause 6A.3 of the Code ("**arm's-length rules**").

1.2 Accordingly, pursuant to section 11 of the Act, WEL is seeking an exemption from complying with clauses 6A.3 and 6A.8 of the Code.

1.3 The costs and inefficiencies associated with WEL complying with the arm's-length rules are expected to be material. WEL would be unlikely to continue to own and operate the New Generation Assets if the arm's-length rules were to apply. Rather than comply with the rules, if WEL does not receive an exemption, the most likely outcome is that WEL would sell one of its Solar Assets (or the permit to construct one of its Solar Assets if construction is not complete) to a third party.

1.4 Consistent with the findings of an economic report prepared by Sapere Research Group ("**Sapere**") on WEL's behalf (attached as **Appendix 3** to this application) ("**Sapere Report**"), WEL submits that the test under section 11 for an exemption is met, as it is not necessary for the purpose of achieving the Authority's objectives under section 15 of the Act for WEL to comply with the arm's-length rules (as per section 11(2)(a) of the Act). In some cases, and as further detailed in this application, obtaining an exemption from the obligation to comply with the arm's-length rules would actually better achieve the Authority's objectives under the Act compared to a scenario where the exemption is not granted (as per section 11(2)(b) of the Act).

1.5 Compared to the likely counterfactual (if WEL were not to receive an exemption), which is an existing or new entrant generator acquiring one of WEL's Solar Assets, the exemption would:

(a) better achieve the Authority's objective of promoting competition in the electricity industry for the long-term benefit of consumers, because:

(i) matching WEL's Solar Assets with the BESS improves the solar generation's competitive rivalry in the wholesale electricity market; and

(ii) WEL's ownership and operation of the New Generation Assets would not create any incentive or opportunity for WEL to impede competition in any relevant New Zealand market, including in respect of any existing or emerging local network support services market;

(b) not negatively impact the Authority's objective of promoting the reliability of electricity supply, because the increase to the supply of instantaneous reserve would be the same with or without the exemption; and

[1] The Authority has recently decided to proceed with its proposal to amend Part 6A of the Code to capture non-rotating generation, including solar (PV) arrays and batteries connected to a distributor's network, as set out in its decision paper dated 2 April 2024. Therefore, from the date the amendment comes into effect on 1 June 2024, the capacity of the New Generation Assets will be captured under Part 6A and count towards the 50MW threshold.

(c) better promote economic efficiency by virtue of the fact that the exemption would result in an increase in competition in the wholesale electricity market as noted in (a) above (and would not result in any lessening of competition in any other market, such as local network support services).

1.6 For completeness, the Sapere Report considers two other less likely counterfactual scenarios – namely, selling the BESS or complying with the arm's-length rules. Even against these (unlikely) counterfactuals, WEL concludes that the test for an exemption is met.

2. CONTEXT OF EXEMPTION APPLICATION

Changes in the electricity industry

2.1 The demand for electricity in New Zealand is increasing significantly due to a range of contributing factors, including population and economic growth, and the electrification of transport and process heat as part of meeting New Zealand's target of net-zero carbon emissions by 2050.[2] The Ministry of Business, Innovation and Employment has stated that achieving the 2050 net-zero emissions target will require "rapid expansion and major acceleration of renewable electricity infrastructure".[3]

2.2 While the rate of investment in renewable generation is increasing, it is estimated that renewable electricity generation needs to increase by 50% to 70% by 2035, and by 170% by 2050.[4] To put it another way, New Zealand must increase its renewable generation capacity by around 400 to 500 megawatts (MW) every year until 2050.[5] As observed by the Authority, this growing electricity demand will increase the required sizes of distribution networks and "create new challenges for managing the congestion on those networks".[6]

2.3 To ensure that New Zealand can achieve this required growth, it is critical that a wider range of industry participants are encouraged and supported to invest in renewable electricity generation. The development of distributed generation assets in particular will help New Zealand to reach its 2050 net-zero emissions target while also creating greater resilience in New Zealand's distribution networks. In the case of distributors, this is especially important given the responsibility on distributors to manage the operation and maintenance of local networks.

2.4 While the advancement of new technologies is driving more efficient use of New Zealand's existing generation capacity (such as demand aggregation and increased network visibility), these developments are unlikely to be sufficient on their own to address the inefficiencies associated with centralised generation in New Zealand. Accordingly, industry participants, and particularly distributors, must be supported to invest in network-level generation and storage now, for the long-term benefit of New Zealand consumers.

2.5 This has been recognised by the Australian Energy Regulator ("**AER**") as part of its recent decision to introduce a class waiver to its 'ring-fencing guideline' (which we understand is broadly equivalent to the arm's-length rules) for battery assets funded under the Australian Government's Community Batteries for Household Solar Program.[7] In its decision, the AER acknowledges that "strict adherence to ring-fencing obligations might, in some circumstances, result in outcomes that are not in the long-term interest of consumers", and that waivers provide "flexibility to support opportunities for genuine innovation".[8] Ultimately the AER determined that "the benefits to consumers of requiring [distributors] to comply with each of

[2] The Climate Change Response Act 2002 was amended in 2019 to set three targets: net-zero carbon emissions by 2050, and biogenic methane emissions reduced below 2017 levels by 10% by 2030 and by 27-47% by 2050.

[3] Ministry of Business, Innovation and Employment *Strengthening National Direction on Renewable Energy Generation and Electricity Transmission* (12 April 2023) at page 1 (https://www.mbie.govt.nz/dmsdocument/26387-strengthening-national-direction-on-renewable-energy-generation-and-electricity-transmission-consulation-doc-pdf).

[4] *Ibid.*

[5] Electricity Authority *Promoting competition in the wholesale electricity market in the transition toward 100% renewable electricity – Issues Paper* (2022) at para [4.5] (https://www.ea.govt.nz/documents/2243/Promoting-competition-in-the-wholesale-electricity-market.pdf).

[6] Electricity Authority, *Energy Transition Roadmap* (December 2021) at para [3.17].

[7] Australian Energy Regulator *Decision, Distribution ring-fencing class waiver for DNSP-led projects funded under the Australian Government's Community Batteries for Household Solar Program* (February 2023) at page 1 (https://rb.gy/t2ps6).

[8] Page 3.

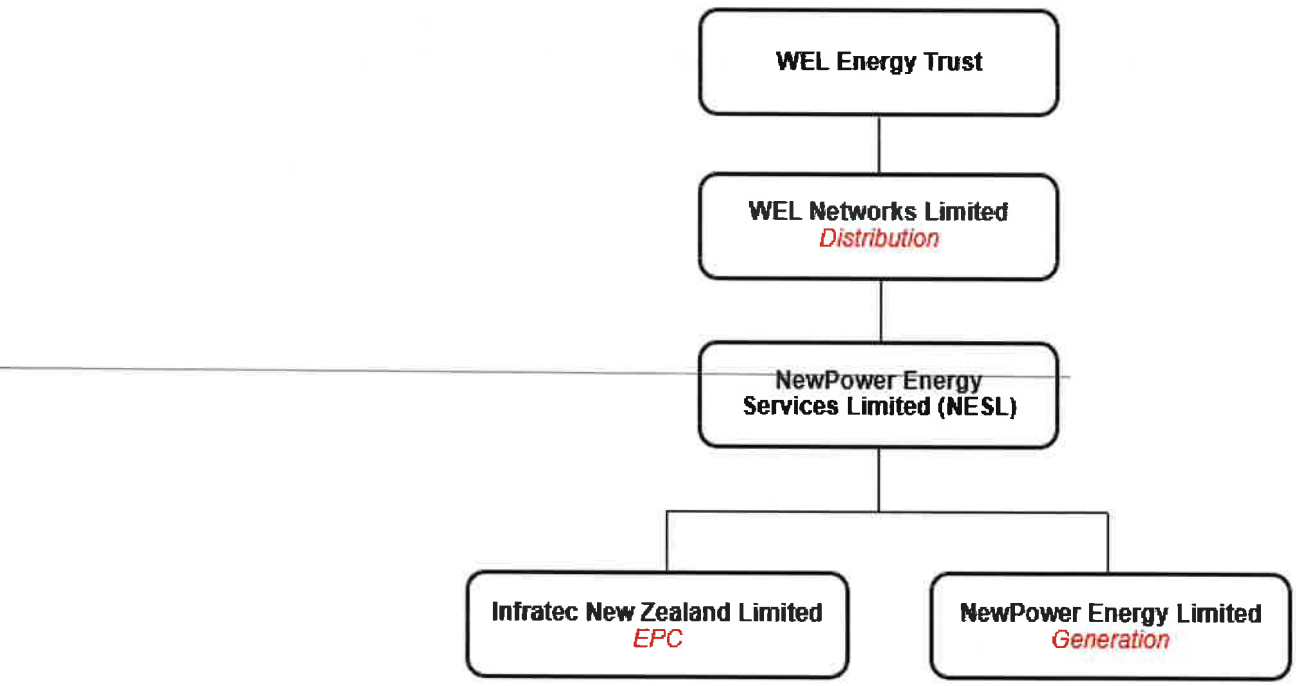
the requirements in the Guideline are outweighed by the costs of compliance with these obligations".[9]

2.6 As done by the AER in the Australian context, the Authority can similarly support distributors to contribute to the innovation of renewable energy solutions in New Zealand. WEL is committed to dealing with the challenges facing the New Zealand electricity industry alongside other industry participants, including by investing in renewable generation to meet the rapid growth in electricity demand. However, as described in the Sapere Report, the requirement on WEL to comply with the arm's-length rules would have the effect of adding avoidable inefficiencies into the electricity industry, which would be inconsistent with the Authority's objectives under the Act.

3. DESCRIPTION OF WEL'S BUSINESS

3.1 WEL and its subsidiaries (together, the "**WEL Group**") build, own and operate over $675M worth of electricity network infrastructure. A company structure of the WEL Group is set out in the diagram in Figure 1 below.

Figure 1: WEL Group company structure



3.2 The relevant entities within the WEL group are as follows:

(a) **WEL**: WEL, a company incorporated in New Zealand, carries on the business of a regulated electricity distributor and owns and operates a local distribution network in

[9] Australian Energy Regulator *Decision, Distribution ring-fencing class waiver for DNSP-led projects funded under the Australian Government's Community Batteries for Household Solar Program* (February 2023) at page 14 (https://rb.gy/t2ps6).

the Waikato region.[10] Through its nearly 7,000 kilometres of lines, WEL services more than 96,000 residential and small business connections and close to 1,000 commercial/industrial sites. Through delivering innovative and sustainable energy solutions WEL has played an essential role in the economic and social development of local communities for over 100 years.

(b) **WEL Energy Trust** ("**Trust**"): WEL is wholly owned by the Trust whose beneficiaries are electricity customers connected to the WEL network. The Trust was established in 1993 and has a Trust Deed to ensure that the company now known as WEL operates as a 'successful company'. Under the Trust Deed, the definition of a 'successful company' includes not only profitability but the need to exhibit a sense of social responsibility by having regard to the interests of the community. The Trust is governed by a board of up to seven trustees, who are elected every three years.

(c) **NewPower Energy Limited** ("**NewPower**"): NewPower is WEL's electricity generation business and is a wholly owned subsidiary of WEL. The current position is that WEL, through Infratec, WEL owns the 4.4MW Naumai solar farm under construction in Northland (which is not connected to WEL's distribution network) and the (consent to construct) the Solar Assets and the BESS. Once constructed, the Naumai solar farm and New Generation Assets will be transferred to NewPower. NewPower Energy Services Limited is the holding entity for NewPower.

(d) **Infratec New Zealand Limited** ("**Infratec**"): Infratec conducts the engineering, procurement and construction business of the WEL Group and is a wholly owned subsidiary of NewPower Energy Services Limited.

(e) **OurPower Limited** ("**OurPower**"): WEL previously operated a wholly owned retailer subsidiary, OurPower, and a small, localised retailer, Raglan Local Energy, collectively involved in the sale of approximately 20GWh of electricity per annum to 3,000 retail customers. On 1 June 2023, WEL divested all of its interests in its retail business on its network by transferring the retail customers of OurPower and Raglan Local Energy to Frank Energy Limited (a wholly owned subsidiary of Genesis Energy Limited). NewPower has assumed Ourpower's rights and obligations in the wholesale electricity market and uses Ourpower's trading code (OURP) to trade electricity.

New Generation Assets

3.3 WEL, using its subsidiary Infratec, is developing the following generation assets which will be connected to its distribution network:

[10] For completeness, it is noted that:

(a) WEL currently has a small amount of generation located at its office buildings in Hamilton that is predominantly used for its own self-supply. The generation capacity of these assets is limited to 271.8 kW of solar, 146 kW of battery, and 200 kW of diesel genset (all of which is currently commissioned and in use, with the exception of 110 kW of solar and 40 kW of battery which is scheduled to be installed at WEL's buildings on McKee Street in Hamilton by December 2024); and

(b) in WEL's view, this small amount of generation capacity does not form part of WEL's exemption application (and it has not been counted for the purposes of calculating WEL's total "connected generation", as described in footnote 14 below) given it is predominantly used for WEL's own self-supply and not commercial generation activities (with only a small amount of excess supply being fed back into the network during weekends and public holidays).

(a) Rotohiko, a battery energy storage system or "BESS" with a total rated energy capacity at full charge of 33.2MW,[11] which has recently been commissioned; and

(b) two solar farms which WEL has recently obtained consent to construct:

(i) Te Ohaaki in Huntly with nameplate capacity of 22.4MW ("**Te Ohaaki**"); and

(ii) Rangimarie in Maramarua, with nameplate capacity of 10MW ("**Rangimarie**"),

(together, the "**New Generation Assets**"). The New Generation Assets will each be connected to WEL's distribution network in the Waikato (via the Huntly GXP) and will be owned and operated by NewPower. However, the solar farms will be in a different location to the BESS, meaning they will not be directly connected to the BESS. See **Appendix 2** for a map which sets out the approximate locations of the New Generation Assets.

3.4 The primary purpose of the New Generation Assets will be to:

(a) In relation to the **BESS**, provide NewPower with an ability to:

(i) arbitrage by purchasing and storing electricity on the national wholesale market when demand is low, and injecting this stored electricity back into the network when demand is high; and

(ii) provide ancillary services to third parties from time to time, such as instantaneous reserve;

(b) **Te Ohaaki and Rangimarie**: generate and inject electricity into the network, for sale by NewPower into the national wholesale market.

3.5 In addition, NewPower could, in theory, provide network support services to WEL's distribution network (but not in practice, as discussed further below).[12] However, the provision of any such network support services would be secondary to the primary purpose of the BESS – namely, to provide a means for NewPower to arbitrage its sale and purchase of electricity on the national wholesale market and to provide ancillary services.

3.6 For the purpose of this application, WEL's working assumption is that the combined capacity of the New Generation Assets would take it beyond the 50MW of connected generation that triggers the arm's-length compliance requirements under clause 6A.3 of the Code.

[11] We note that, while the BESS has a total rated energy capacity of 33.2MW, WEL's interpretation of the Authority's recent amendments to the definition of "connected generation" in Part 6A of the Code (which come into effect on 1 June 2024) is that:

(a) the "maximum capacity" of the BESS is required to be calculated according to the maximum amount that is: (a) offered into the wholesale market; (b) gifted into the wholesale market; (c) contracted to Transpower as an ancillary service; or (d) if not included in (a), (b), or (c), the nameplate capacity of the generating unit; and

(b) therefore, as the BESS is captured under limb (c) above, the "maximum capacity" of the BESS for the purposes of Part 6A will be equivalent to its approved ancillary services capacity of 32.945MW (rather than its total rated energy capacity of 33.2MW).

[12] WEL's requirements for network support services in relation to the Huntly network system are expected to be small over long-term, given that the level of growth forecast for the Huntly network system is low. For example, the projected growth of capital expenditure for the Huntly network system is only $16 million for the period of 2024-2033, compared to $88.9 million and $60 million for the Hamilton and Te Kowhai network systems (respectively) over the same period.

4. APPLICATION OF ARM'S-LENGTH RULES TO WEL

Nature of the involvement

4.1 Clause 6A.2 of the Code gives "involved in" the same meaning as the equivalent term under section 6A of the Act, which provides that a person is "involved" in a distributor, a generator or a retailer if the person:

> (c) has a material influence over a business that does any of those things [distribution, generation or retail].

4.2 Therefore, for the purposes of Part 6A of the Code, the following persons would be "involved in" both a distributor (WEL Networks) and a generator (NewPower):

(a) WEL (as the parent company of the WEL Group);

(b) all current and future:

(i) directors of WEL;

(ii) c-suite executives employed by WEL; and

(iii) managers employed by WEL with roles and/or responsibilities related to NewPower's generation business.

Applicability of sections of Part 6A.3 of the Code

4.3 Clause 6A.3(2) of the Code provides that:

> Every person who is involved in a distributor, and every person who is involved in a connected generator or a connected retailer, must comply, and ensure that the person's businesses comply, with the arm's-length rules.

4.4 In this clause, unless the context otherwise requires:[13]

> **connected generator**, in relation to a distributor, means a generator:
>
> (a) that has connected generation of more than 50 MW of generation that is connected to any of the distributor's networks; and
>
> (b) in respect of which the distributor, or any other person involved in the distributor, is involved.

4.5 This application assumes that NewPower will be a "connected generator" for the purposes of clause 6A.3 of the Code. This is because, once the New Generation Assets are connected to WEL's network, the total connected generation of NewPower will be more than 50MW.[14]

[13] As noted in footnote 1 above, the Authority recently released its decision (dated 2 April 2024) to amend Part 6A of the Code, which will come into effect on 1 June 2024. For the purposes of this application, the applicability of Part 6A.3 is considered under the relevant provisions in the Code as amended by the Authority's recent decision.

[14] The total capacity of WEL's generation assets connected to its networks would be 65.345MW based on the "maximum capacities" of the following assets: Rotohiko network connected battery in Huntly (32.945MW); Te Ohaaki solar generator in Huntly (22.4MW); and Rangimarie solar generator in Maramarua (10MW). See footnote 11 above for further details of WEL's interpretation of the Authority's recent changes to Part 6A in respect of calculating the "maximum capacity" of the BESS.

5. DESCRIPTION OF EXEMPTION SOUGHT

Why WEL is seeking an exemption from clause 6A.3 of the Code

5.1 Pursuant to section 11(2) of the Act, this application seeks, in respect of WEL's involvement in NewPower, an exemption from compliance with clauses 6A.3 and 6A.8 of the Code ("**Proposed Exemption**").

5.2 As mentioned above, and as detailed further in this application, WEL is a suitable candidate for exemption from compliance with clauses 6A.3 and 6A.8 of the Code, because it is not necessary for the purpose of achieving the Authority's objectives under section 15 of the Act for WEL to comply with the arm's-length rules, and, in some cases, the Proposed Exemption would better achieve the Authority's objectives under the Act than requiring compliance.

5.3 We note that the Proposed Exemption would be specific to WEL's involvement in the New Generation Assets held by NewPower. It does not extend to any other interest or future involvement of WEL in generation.

How long the exemption is required for

5.4 WEL is requesting the exemption from the date at which the second and final Solar Asset is connected to its distribution network and for a minimum period of twenty-five (25) years (based on the life of the assets being 25 to 30 years) for WEL to make a reasonable return on its investment.

Alternatives to an exemption that have been explored – the "counterfactual"

5.5 The Sapere Report describes three hypothetical "counterfactuals" which *could* occur if the Proposed Exemption is not granted:[15]

(a) WEL sells Te Ohaaki to either an existing generator or a new entrant to the wholesale electricity market (**Counterfactual 1**);

(b) WEL sells the BESS to an existing generator (**Counterfactual 2**); or

(c) WEL complies with the arm's length rules (**Counterfactual 3**).

5.6 However, as described further below, Counterfactual 1 is the only *likely* counterfactual. For this reason, WEL submits that this is the only counterfactual against which the Authority should assess whether the section 11(2) test for an exemption is met.

Previous similar exemptions by the Authority

5.7 The Authority has previously considered applications for exemption from the arm's-length rules, including (for example) a recent application by Top Energy Limited ("**Top Energy**") in relation to the expansion of its geothermal generation assets at the Ngāwhā Springs Power Station.[16] Top Energy's exemption application was made following the arm's-length rules

[15] Sapere Report, section [4.2].

[16] Electricity Authority, *Final Decision No. EA 333 in relation to Top Energy Limited* (15 December 2023).

being moved from the Act into the Code, meaning the Authority was required to consider the application for exemption from the arm's-length rules under section 11 of the Act.[17]

5.8 We consider that the Authority's decision to grant Top Energy's application for exemption from the arm's-length rules is relevant and provides a useful point of reference for the assessment of WEL's application. However, WEL considers there are important differences between the two applications. Namely:

(a) While Top Energy's application concerned an expansion of its geothermal generation to a total of 117MW, which exceeds the 50MW threshold by a considerable margin, WEL is applying to have a relatively small increment of generation capacity above the 50MW threshold, with WEL's total connected generation to increase to only 65.345MW if the Proposed Exemption is granted.

(b) The potential generation output of the Solar Assets, as calculated in GWh per annum, is much smaller than the output of a geothermal plant of the same capacity. This is because intermittent renewable generation, such as solar, is not able to run 'continuously' in the same way as a geothermal plant. As a result, WEL estimates that while 50MW of solar generation would only be capable of generating up to ~80GWh per annum, a 50MW geothermal plant would be capable of generating up to five times that amount (i.e. ~400GWh per annum).

5.9 WEL submits that these differences contribute to demonstrating that the test under section 11 for an exemption is met, given that, compared to the potential impact on competition of granting Top Energy's application for exemption from the arm's-length rules, any potential impact on competition if the Proposed Exemption is granted is likely to be much less material.

Impact on overall scheme of the Code

5.10 The purpose of Part 6A the Code is to promote competition in the electricity industry by restricting relationships between a distributor and a generator where those relationships may not otherwise be at arm's-length. We consider that the Proposed Exemption is consistent with the objectives of Part 6A of the Code, given that the arm's-length rules are not necessary to promote competition in the electricity industry in relation to WEL's involvement in NewPower, as described further below and in the findings of the Sapere Report.

No adverse effects on other participants

5.11 As described further below, the Proposed Exemption would not result in any adverse effects on other participants in the electricity industry. In particular:

(a) The generation capacity added by WEL to the national wholesale market (being the very small increment by which WEL's generation capacity would exceed the 50MW threshold) is "tiny relative to the size of the market, making WEL a 'price taker' in the wholesale market".[18] The relative significance of the incremental increase of WEL's generation capacity will be further diminished as the Government continues to fast-track new renewable generation projects to meet New Zealand's emissions reduction

[17] Under sections 50 and 54 of the Electricity Industry Amendment Act 2022, which came into force on 1 September 2022, the arm's-length rules were removed from Schedule 2 of the Act and inserted into a new Schedule 6A.1 of the Code. As a result of this change, an application for an exemption to the arm's-length rules must now be made under section 11 of the Act, which deals with exemptions from the Code, whereas previously an application would have been made under section 90 of the Act, which deals with exemptions from the Act.

[18] Sapere Report, section [5.5.3].

targets.[19] Accordingly, WEL will have no ability to influence the price paid or received by other participants in the national wholesale market.

(b) The Proposed Exemption does not create any risk of foreclosure in any of the relevant markets. We note that, while WEL could potentially be the purchaser and supplier in the market for local network support services on WEL's network, the fact that the New Generation Assets are connected to a high capacity 33kV line means that there is no physical constraint on an alternative provider competing with the New Generation Assets to provide local network support services to WEL.[20]

(c) Furthermore, there is no opportunity or incentive for WEL to leverage its monopoly distribution business to cross-subsidise the contestable activities that it will undertake with the New Generation Assets. This would effectively require WEL to undermine its business model by overcharging its distribution customers (which are also its owners under the consumer-owned trust model and which would attract increased and unwanted scrutiny from the Commerce Commission) or by operating at below-cost pricing, which WEL clearly has no incentive to do.[21]

6. EFFECTS OF THE PROPOSED EXEMPTION ON THE AUTHORITY'S STATUTORY OBJECTIVES

(a) The exemption promotes competition in the electricity industry

The relevant markets in the electricity industry

6.1 Consistent with the Sapere Report, the relevant markets for the purposes of this application are:[22]

(a) the national wholesale market for electricity;

(b) the North Island wholesale market for ancillary services, excluding voltage support;

(c) an upper North Island wholesale market for voltage support; and

(d) the local network support services market, supplying either Transpower or WEL.

6.2 That being the case, those markets are adopted as the relevant markets for the purpose of this application.

Competitive analysis against the likely (and unlikely) counterfactuals

6.3 Consistent with the approach previously adopted by the Authority, the likely effect of the Proposed Exemption on competition in the relevant markets should be determined by applying a counterfactual analysis.[23] That is, the Authority should compare the likely state of competition if the Proposed Exemption is granted (the **"Factual"**) with the likely state of competition if the Proposed Exemption is not granted (the **"Counterfactual"**).

[19] For example, since late 2021 the Government has referred five significant renewable generation projects through the COVID-19 Recovery (Fast-track Consenting) Act 2020, including two large solar farm projects in the Waikato region, which could collectively add more than 635MW to the national grid. See *Government refers solar energy projects for fast-track consenting* (14 April 2023) at https://www.beehive.govt.nz/release/government-refers-solar-energy-projects-fast-track-consenting.

[20] Sapere Report, section [5.6].

[21] Sapere Report, section [5.5.4].

[22] Sapere Report, section [3.6].

[23] Electricity Authority, *Final Decision No. EA 333 in relation to Top Energy Limited* (15 December 2023) at paras [8.1] to [8.2].

6.4 However, a counterfactual must be "likely", which is to say that there must be a "real and substantial risk" that it will happen.[24] If the Proposed Exemption is not granted, we consider that the only "likely" outcome would be Counterfactual 1. This is because, based on the strategic and commercial incentives faced by WEL in this scenario, the sale of Te Ohaaki would be the most rational decision available to WEL. WEL would continue to own and operate the BESS and the Rangimarie solar farm, and its total generation capacity (~43.2MW) would remain below the 50MW threshold that triggers the arm's-length requirements.

6.5 In comparison, while Counterfactual 2 and Counterfactual 3 are hypothetically possible, they are unlikely to happen given the opportunity costs and real costs that WEL would be required to incur. For example:

(a) if WEL was to sell the BESS under Counterfactual 2, it would lose the ability to match its Solar Assets with the BESS (such that electricity could not be stored when demand is low, and injected back into the network when demand is high), which is one of the key commercial drivers behind WEL's investment in the New Generation Assets; and

(b) the costs and inefficiencies associated with WEL complying with the arm's-length rules under Counterfactual 3 are likely to be material (including costs of reduced synergies across WEL's business, the duplication of boards of directors, executive teams, offices and operational support for each of WEL and NewPower, together with costs related to corporate restructuring, funding, and commercial arrangements, including less favourable rates for funding and other services).

6.6 Accordingly, WEL submits that Counterfactual 1 is the only counterfactual against which the Authority should assess whether the section 11(2) test for an exemption is met.

6.7 However, for completeness, this application follows the approach of the Sapere Report by considering the likely state of competition of the Factual with all three Counterfactuals.

Counterfactual 1: WEL sells Te Ohaaki to an existing generator or a new entrant to the wholesale electricity market

6.8 The relevant market for Counterfactual 1 is the national wholesale market (noting that Te Ohaaki would not participate in the markets for ancillary or network services). As described in the Sapere Report, the difference in competition in the national wholesale market between Counterfactual 1 and the Factual is negligible. In either scenario, the owner of Te Ohaaki would likely be a 'price-taker' given that electricity output from solar farms is not controllable.[25] In addition, for the purposes of the section 11(2) test, the increment by which WEL's generation capacity would exceed the 50MW threshold in the Factual is very small, which further diminishes the significance of WEL's added generation to the national wholesale market.

6.9 However, an important difference is that, under the Factual, WEL would have the ability to 'match' Te Ohaaki with the BESS. The matching of solar generation with battery increases the competitive rivalry of the solar asset by enabling the owner to store electricity when demand is low (for example when the sun is shining) and inject that electricity when demand is high (for example during the evening peak). This arbitrage of WEL's activities in the wholesale electricity market will benefit consumers by introducing an additional source of electricity supply during peak periods, resulting in an increase in the competitive rivalry of Te Ohaaki.

[24] *Woolworths & Ors v Commerce Commission*, 8 NZLBC 102,128 (HC 2008) at para [110].
[25] Sapere Report, section [5.3].

6.10 It is likely that some of these benefits to consumers would be lost under Counterfactual 1, because:

(a) WEL would be unable to arbitrage its activities in the wholesale electricity market to the same extent (given that WEL's only remaining Solar Asset under Counterfactual 1 would be Rangimarie, which has a relatively small generation capacity); and

(b) the purchaser of Te Ohaaki is unlikely to have a network battery to match with Te Ohaaki.

6.11 Accordingly, the Factual would likely promote competition in the wholesale electricity market compared to Counterfactual 1.

Counterfactual 2: WEL sells the BESS to an existing generator

6.12 All of the markets set out under paragraph 6.1 are relevant to Counterfactual 2.

(a) Ancillary services

6.13 Under the Factual, WEL would primarily use the BESS to enter the market for the provision of ancillary services (such as instantaneous reserves and voltage support). This would result in an increase to competition compared to Counterfactual 2, given the purchaser of the BESS would likely be an existing or future generator (because ownership of the BESS would not make economic sense without accompanying generation).

6.14 As a new entrant in the market for ancillary services, and as noted in the Sapere Report, WEL would increase competition in the market for ancillary services by bringing "its own perspectives and would compete against existing entities to win and retain sales of its services".[26] The Authority has identified network batteries as playing an important role in increasing innovation and competition in the reserves market, with the potential to reduce transmission costs and increase grid security and reliability.[27] Further, the use of batteries to supply ancillary services may, in addition to increasing price competition, result in improvements in non-price factors such as increased responsiveness.[28]

6.15 It is unlikely that these benefits would be realised to the same extent if an existing generator owned the BESS, given there would be no increase in the number of competitors in the market for ancillary services under Counterfactual 2.

6.16 Accordingly, the Factual would result in an increase in competition in the ancillary services market compared to Counterfactual 2.

(b) National wholesale market

6.17 In the national wholesale market, and as mentioned above, WEL would, in the Factual, 'match' the BESS with its Solar Assets for the purpose of storing electricity when demand is low, and selling electricity when demand is high. WEL's ability to arbitrage its generation activities in

[26] Sapere Report, section [5.2].

[27] On 3 May 2022, the Code was amended (pursuant to clause 4(1) of the Electricity Industry Participation Code Amendment (Enabling Energy Storage Systems to Offer Instantaneous Reserve) 2022) to allow battery energy storage systems (EES) to offer generation reserve. The Authority noted that the entry of EES into the reserves market is to "enable more innovation and competition in the reserves market" and "benefit consumers by helping competition amongst reserve providers in the wholesale market and help provide a reliable electricity supply" (https://www.ea.govt.nz/projects/all/energy-storage-systems-as-instantaneous-reserve/).

[28] For example, in respect of the market for voltage support, Sapere notes that "a BESS can provide reactive power over a greater operating range than a standard generating machine, and because the response is programmable and fast, then it could provide [voltage support] in excess of any Code requirements" (see Appendix B of the Sapere Report, at page 26).

this manner will introduce an additional source of electricity supply to the wholesale market during periods of peak demand, which will in turn increase the competitive rivalry of the Solar Assets. While the increase in competitive rivalry will be small (given the amount of additional generation produced by the Solar Assets is relatively small), the ultimate effect would be a marginal increase in the sources of supply of electricity during peak periods for the benefit of consumers.

6.18 Accordingly, the Factual would result in a modest increase in competition in national wholesale market compared to Counterfactual 2.

(c) Network support services market

6.19 While the BESS will be primarily used to provide ancillary services (such as instantaneous reserves) to third parties, it cannot be ruled out that, on occasion, it would be used for the purpose of self-supplying network support services to WEL's distribution network.

6.20 WEL is the only purchaser of network support services on its network. However, given that WEL does not intend on using the BESS for network support services under the Factual (for the reasons explained in paragraph 6.22 below), other than on rare occasions, we do not consider that the scale of network support services required by WEL from third parties would be any greater under Counterfactual 2. That is, if WEL sold the BESS to a third party, the impact of the sale on WEL's requirements for network support services would be negligible.

6.21 Further, because the BESS is connected to a high-capacity 33kV line and the capacity at the relevant GXP (Huntly) is not constrained, WEL would have no physical advantages compared to an alternative provider competing to provide network support services to WEL's network. In other words, the connection of the BESS to WEL's network would not introduce any capacity constraints that would prevent a third party from fulfilling WEL's full requirements for network support services in respect of its local network.

6.22 WEL has no incentive to fulfil its requirements for network support services from the BESS to the extent that there are lower cost alternative providers available. Instead, the commercial incentive on WEL would be to apply the capacity of the BESS towards its primary purpose of providing arbitrage on the national wholesale market and ancillary services to third parties, given that WEL would receive a higher return from the BESS in the wholesale and ancillary services markets in this situation.

6.23 Accordingly, the level of competition in the market for network support services would be the same under the Factual and Counterfactual 2.

Counterfactual 3: WEL complies with the arm's-length rules

6.24 All of the markets set out under paragraph 6.1 are relevant to Counterfactual 3.

(a) National wholesale and ancillary service markets

6.25 The costs and inefficiencies associated with WEL complying with the arm's-length rules are likely to be material. As described under paragraph 6.5(b) above, this includes (but is not limited to) the costs of reduced synergies across WEL's business, the duplication of boards of directors, executive teams, offices and operational support for each of WEL and NewPower, together with costs related to separating out corporate structure, funding, and commercial arrangements, including less favourable rates for funding and other services due to the weakened bargaining power of smaller scale businesses. Given that these costs would not be faced by other generators in the wholesale and ancillary services markets, WEL would be

less competitive in those markets compared to the Factual and the overall level of competitive rivalry in these markets would be reduced.

6.26 Accordingly, the Factual would result in an increase in competition in national wholesale and ancillary services markets compared to Counterfactual 3.

(b) Network support services

6.27 In terms of the market for network support services, the separation of WEL's distribution and generation businesses would have no impact on the ability for a third party to compete for those services compared to the Factual. As noted under paragraph 6.20 above, WEL does not intend on using the BESS for network support services under the Factual, other than on rare occasions, because WEL would be able to obtain a higher return from the BESS in the wholesale and ancillary services markets.

6.28 Under Counterfactual 3, this would also be the case. The commercial incentive on WEL's generation business (when operating at arm's-length from WEL's distribution business) would be to use the BESS for generation activities in the wholesale and ancillary services markets. The incentive on WEL's generation business to compete to provide network support services to WEL's distribution business would remain unchanged.

6.29 Accordingly, the level of competition in the market for network support services would be the same under the Factual and Counterfactual 3.

Would the exemption create incentives and opportunities to inhibit competition in the electricity industry?

6.30 Under the former test under section 90 of the Act, the Authority would also consider whether an exemption to the arm's-length rules would create incentives and opportunities to:

(a) inhibit competition in the electricity industry; and/or

(b) cross subsidise the connected generator.

6.31 For completeness, we also address these questions in the context of each of the relevant markets.

6.32 Other than in respect of the market for network support services, WEL's competitors in the relevant markets do not require an essential input from WEL in order to provide their services to those markets.[29] Therefore, while businesses almost always have an incentive to gain an advantage on their competitors if they can, the Proposed Exemption cannot, and does not, create any opportunities for WEL to inhibit competition in those markets.

6.33 WEL acknowledges that it is responsible for assessing applications to connect new generation to its network and that, in this context, the Proposed Exemption could (in theory) create opportunities for WEL to restrict access to its network for its competitors in the national wholesale and ancillary service markets. However, in practice, any such opportunity would:

(a) not coincide with any incentive to restrict access given that any additional generation on WEL's network would be too small to impact the prices paid or received by WEL in those markets, as against the certainty of connection fee revenue; and

[29] Sapere Report, section [5.5.3].

(b) be limited by the fact that WEL is required to adhere to Part 6 of the Code when assessing and allowing connections of distributed generation to its network. That is to say it is constrained in its ability to actually foreclose generators on its network, because it must provide access where such generators meet the criteria and conditions stipulated in the Code, including the requirement to apply pricing principles.[30] Any decision by WEL to refuse connection can be challenged.

6.34 Further, as WEL would continue to own generation on its network in the Factual and all of the Counterfactuals, these opportunities to WEL (or lack thereof) would be the same in any of these scenarios, and it is not the case that the very small increment by which WEL's generation would exceed the 50MW threshold would create or increase any theoretical incentive and opportunity to foreclose WEL's generation rivals.

6.35 Similarly, WEL's total generation capacity under the Factual will be too small for WEL to impact the prices paid or received by other participants national wholesale market, meaning WEL will be a 'price taker' in that market. Further, the rules which govern pricing in the national wholesale market are determined and applied independently by the Authority, which also prevents WEL from having any ability to inhibit competition in that market.[31]

6.36 Similarly, in the market for ancillary services (including voltage support), WEL would have no opportunity to use the BESS to influence the competitive tender process conducted by Transpower in respect of the provision of ancillary services. Under the Factual, there is no action that WEL would take that would increase the costs to its competitors in the market for ancillary services, or which would influence Transpower to choose WEL as a supplier over a more competitive alternative.[32]

6.37 In relation to incentives or opportunities for WEL to use its monopoly distribution business to cross-subsidise its generation activities, we note that this would require WEL to:[33]

(a) charge its distribution customers (who also own WEL under the WEL Trust model) prices which exceed efficient operation costs; and

(b) use the extra profit earned from overcharging its distribution customers to subsidise its generation activities in the wholesale and/or ancillary services markets.

6.38 As observed in the Sapere Report, any decision by WEL to overcharge its customers and owners would directly undermine the purpose of WEL's business, which is established under a consumer-owned trust for the benefit of its network users. Further, the fact that consumer-trust owned distributors are not currently subject to price control under Part 4 of the Commerce Act demonstrates that there is no incentive on consumer-owned distributors to over-charge their network users when price control is a possible regulatory response.

6.39 Moreover, any cross-subsidisation of WEL's generation business which required WEL's distribution business to forgo a normal return on its investment is not supported by any economic rationale. There would be no commercial benefit to WEL of such a strategy. In particular, the level of cross-subsidisation that WEL could possibly achieve would be

[30] In particular, clause 6.11 requires distributors to act at arm's length and requires a distributor to use, in respect of all distributed generators, the same reasonable efforts in processing and considering applications for connection. This rule applies regardless of whether the distributor has an ownership interest or a beneficial interest in the distributed generator and regardless of who the distributed generator is.

[31] *Ibid.*

[32] *Ibid.*

[33] Sapere Report, section [5.5.4].

insufficient to enable WEL to force its upstream competitors to exit the wholesale or ancillary services markets.

6.40 For the reasons set out under paragraphs 6.21 and 6.22 above, there is no incentive or opportunity for WEL to use its monopoly distribution business to inhibit competition or cross-subsidise the BESS in respect of the market for network support services. In particular:

(a) given the BESS is connected to a high-capacity 33kV line and the capacity at the relevant GXP (Huntly) is not constrained, WEL would have no physical advantages compared to an alternative provider competing to provide network support services to WEL's network; and

(b) if available, WEL would be incentivised to use lower cost alternative providers of network support services, and to apply the BESS towards its primary purpose of providing ancillary services (or secondly to provide arbitrage on the national wholesale market), given that WEL would receive a relatively higher return from the BESS in the those markets.

(b) The exemption does not undermine the reliability of supply by the electricity industry

6.41 The New Generation Assets would be operated and contribute to the supply of electricity under both the Factual and each of the Counterfactuals. Accordingly, there would be no difference to the reliability of supply between the different scenarios.[34]

(c) The exemption promotes the efficient operation of the electricity industry

6.42 As discussed above, the increase in competition in the relevant markets would increase economic efficiency, given the competitive process a means through which efficient outcomes are created.[35]

6.43 Further, each of the Counterfactuals would result in higher costs compared to the Factual. In the absence of any increase in competition in the relevant markets (which we submit would be the case in each of the Counterfactuals), the incurrence of such costs would therefore result in a relatively less efficient outcome in the absence of any gains in competition.

7. CONFIDENTIALITY

7.1 This application is being provided to the Authority on a confidential basis. WEL requests that it is notified in writing prior to the release of any of the information contained in this application, and that WEL's views on confidentiality are considered before any such disclosure takes place.

8. DECLARATION

8.1 Please see **Appendix 1** to this application for a declaration completed by WEL (in the form prescribed under the former section 90 application process).

8.2 Please let us know if you have any questions or if you require any further information.

[34] Sapere Report, section [6.1].
[35] Sapere Report, section [6.2].

9. ADDITIONAL INFORMATION

9.1 We set out **below** a summary of our views on the likely impact of the Proposed Exemption in the relevant markets in respect of the Counterfactual 1, which is the most likely outcome if the Proposed Exemption is not granted.

Table 1: Compared to Counterfactual 1, will the exemption promote competition in, reliability of supply by, and efficient operation of, the electricity industry?

	Competition	**Reliability**	**Efficiency**
Wholesale	Positive impact	No impact	Positive impact
Ancillary Services (excl voltage support)	No impact	No impact	No impact
Voltage Support	No impact	No impact	No impact
Network Support	No impact	No impact	No impact

Table 2: Will the exemption create incentives and opportunities to inhibit competition in the electricity industry?

		WEL sells Te Ohaaki (counterfactual)	**Exemption granted (factual)**
Wholesale	**WEL**	No impact	No impact
	NewPower	No impact	No impact
Ancillary Services (excl voltage support)	**WEL**	No impact	No impact
	NewPower	No impact	No impact
Voltage Support	**WEL**	No impact	No impact
	NewPower	No impact	No impact
Network Support	**WEL**	No impact	No impact
	NewPower	No impact	No impact

Table 3: Would the exemption create incentives or opportunities for a distributor to cross-subsidise a generator?

		WEL sells Te Ohaaki (counterfactual)	**Exemption granted (factual)**
Wholesale	**WEL**	No impact	No impact
	NewPower	No impact	No impact
Ancillary Services (excl voltage support)	**WEL**	No impact	No impact
	NewPower	No impact	No impact
Voltage Support	**WEL**	No impact	No impact

	NewPower	No impact	No impact

Network Support	**WEL**	No impact	No impact
	NewPower	No impact	No impact

APPENDIX 1: DECLARATION

THIS APPLICATION is made by:

WEL Networks Limited

WEL Networks Limited hereby confirms that:

- all the information requested by the Electricity Authority (**Authority**) is provided;
- all relevant information known to the applicant is provided; and
- all information provided is true and correct as at the date of this application.

WEL Networks Limited undertakes to advise the Authority immediately of any material change in circumstances relating to the application.

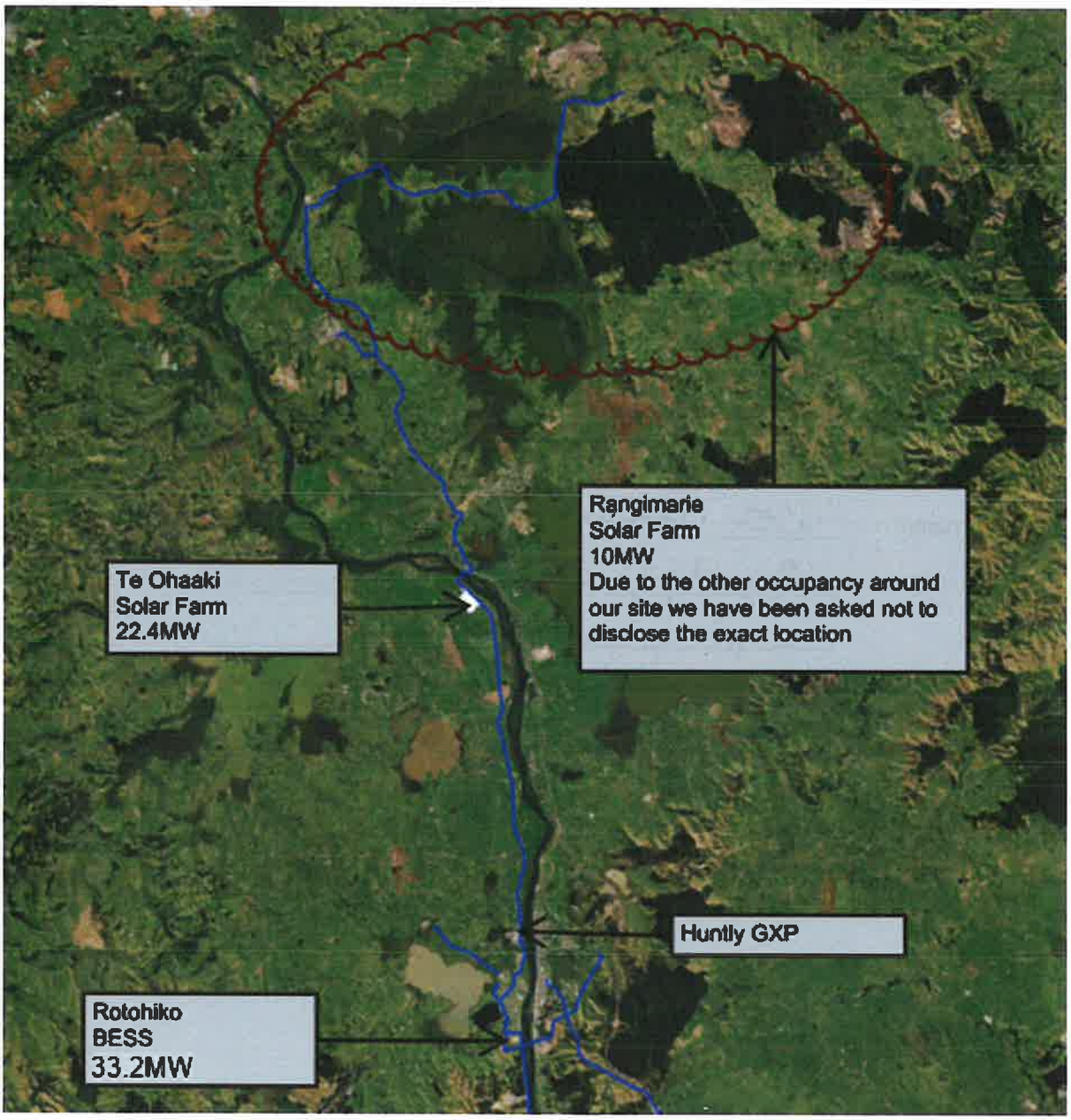
Company name: WEL Networks Limited

Date: 3. May 2024

Signed by:

Position: GM Commercial Engagement

APPENDIX 2: MAP OF NEW GENERATION ASSETS



APPENDIX 3: SAPERE REPORT

Attached.